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In the Supreme Court of the United States

OCTOBER TERM, 1946

IN THE MATTER OF PITTSBURGH RAILWAYS COMPANY, DEBTOR

No. 1178

PHILADELPHIA COMPANY, PETITIONER

v.

JULES GUGGENHEIM, ET AL.

No. 1179

PHILADELPHIA COMPANY, PETITIONER

v.

JULES GUGGENHEIM, ET AL.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the district court on the motion filed November 23, 1945 (R. 27–29), is reported at 64 F. Supp. 231. The opinion of the

district court on the petition filed March 6, 1946 (R. 77–81), has not been reported. The opinion of the circuit court of appeals (R. 85–90) is reported at 159 F. 2d 630.

JURISDICTION

The orders of the circuit court of appeals were entered on December 31, 1946 (R. 91–92). The petition for writs of certiorari was filed on March 29, 1947. The jurisdiction of this Court is involved under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1935, made applicable here by Section 121 of Chapter X of the Bankruptcy Act (11 U. S. C. 521).

QUESTION PRESENTED

The reorganization court had ordered an investigation into causes of action against the debtor's parent company, petitioner herein, and into grounds for the subordination or limitation of its claims. The parent company urged that an investigation be made into the identity of the debtor's public security holders and into the time and cost of their acquisitions. Petitioner alleged no breach of fiduciary obligation or other misconduct, but only that many of their purchases were made during the reorganization, at discounts under par, and with notice of grounds asserted for subordinating or limiting the parent company. Petitioner also contended that establishment of these facts would justify subordination or limitation of the claims of such petitioners

or the mitigation or avoidance of subordination or limitation of the claims of the parent.

The question is whether the court below correctly held the asserted facts to be irrelevant and properly affirmed the district court's refusal to order the investigation of the public security holders.

STATEMENT

The case involves judgments in two appeals made in proceedings under Chapter X of the Bankruptcy Act for the reorganization of Pittsburgh Railways Company, the debtor. Philadelphia Company, the petitioner, is a holding company in the Standard Gas & Electric system. It is the parent of the debtor and of most of the so-called underlier companies comprising the debtor's street railway system and is also a substantial creditor of the debtor and many of the underliers (R. 18). The reorganization proceedings for the street railway system have been pending for nine years, since May 10, 1938, and various steps therein have been the subject of extensive litigation.[1]

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[1] *Philadelphia Company* v. *Dipple*, 312 U. S. 168, affirming *In re Reorganization of Pittsburgh Railways Co.*, 111 F. 2d 932 (C. C. A. 3); *In re Pittsburgh Railways Co.*, 117 F. 2d 1007 (C. C. A. 3); *In the Matter of Pittsburgh Railways Co.*, 155 F. 2d 477 (C. C. A. 3), certiorari denied *sub nom. In the Matter of Pittsburgh Railways Co., Philadelphia Company et al.* v. *Guggenheim et al.*, Nos. 359–364, this Term (October 14, 1946); *Philadelphia Company* v. *Securities and Exchange Commission*, now pending in the U. S. Court of Appeals for the District of Columbia.

Guggenheim et al., public security holders of the debtor and several underliers (R. 34), filed a petition requesting an investigation under Sections 21 (a) and 167 of the Bankruptcy Act, 11 U. S. C. 44 (a) and 567, into possible claims or causes of action available to the estate against Philadelphia Company or any other party, and into grounds for the subordination or equitable limitation of claims filed by Philadelphia Company (R. 15). On November 7, 1945, the district court refused Philadelphia Company's motion to dismiss; did not adopt its suggestion that, if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors" (R. 16, 22–23, par. (4)); and directed the trustee to conduct the investigation prayed for (R. 19–21). No appeal has been taken from this ruling and the investigation has since proceeded as ordered.

Philadelphia Company, the petitioner herein, thereafter took two steps.

1. It moved to amend this order so as to have the inquiry relate not only to itself but to all holders of the securities and liabilities of the debtor, including public holders, whether or not they filed claims on their holdings (R. 21–23). It urged that members of the public had bought large amounts of the debtor's securities during the reorganization at low prices; that these purchases were made when the question of Philadelphia Company's subordination by reason of its pre-

vious conduct respecting the debtor had been raised; that the market prices of the securities had gone up substantially since the inception of the proceedings; that any further enhancement by reason of Philadelphia Company's subordination might result in the "unjust enrichment" of such purchasers; that these facts, if established, warranted the court in denying them the benefits, in whole or in part, of any subordination or limitation of Philadelphia Company's claims, or in subordinating the claims of these security holders; and that the court should therefore order an inquiry into the identity of the public security holders and the time and cost of their purchases (R. 68, 71–73; see also Pet. 6–7). The district court held that the showing of facts made by petitioner was inadequate to warrant adding to the subject of the investigation the matters urged by petitioner and it denied the motion, though in effect without prejudice to its later renewal on a proper showing of facts (R. 27–29).

2. Shortly after filing a notice of appeal from this order, Philadelphia Company presented a petition, which, after reciting the identical substantive facts and conclusions that it had previously urged upon the court in support of its rejected motion, prayed for the identical relief—the expansion of the investigation in the respects set forth above. The district court, after hearing petitioner and various objecting parties (R. 51–71), determined that it would not receive

evidence offered by Philadelphia Company in support of the aforesaid disputed factual allegations (R. 71, 76), and subsequently dismissed the petition, again without prejudice (R. 81).

The circuit court of appeals affirmed the two refusals of the district court to order the requested investigation (R. 91–92).

The Securities and Exchange Commission, pursuant to Section 208 of the Bankruptcy Act (as added by the Act of June 22, 1938, c. 575, § 1, 52 Stat. 894, 11 U. S. C. 608), is a party to the proceedings for the reorganization of Pittsburgh Railways Company, debtor, under Chapter X of the Bankruptcy Act in the District Court for the Western District of Pennsylvania and was an appellee in the court below.

STATUTES INVOLVED

Bankruptcy Act, Section 21 (a), 11 U. S. C. 44 (a):

> The court may, upon application of any officer, bankrupt, or creditor, by order require any designated persons, including the bankrupt and his or her spouse, to appear before the court or before the judge of any State court, to be examined concerning the acts, conduct, or property of a bankrupt * * *.

Bankruptcy Act, Chapter X, Section 167, 11 U. S. C. 567:

> The trustee upon his appointment and qualification—
>
> (1) shall, if the judge shall so direct,

forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate; * * *

ARGUMENT

The question presented involves efforts of Philadelphia Company, after unsuccessfully attempting to escape an investigation into its management of the debtor, its subsidiary, to add thereto an investigation into public holders of the debtor's securities and holders of its other liabilities. In our view the holding below was clearly correct and presents no conflict with the rulings in other circuits or with any decision of this Court.

The circuit court of appeals held that the facts that purchases had been made at a discount, during the reorganization, and with notice of wrongdoing by Philadelphia Company were irrelevant, because, even if established, they did not, in the

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absence of fraud or other misconduct, subject the public purchasers to subordination or bar them from benefiting through the subordination of Philadelphia Company (R. 89–90). It held, therefore, that the identity of public security holders and the time and cost of their acquisitions were immaterial to any issue in the reorganization, and that consequently, there was no basis for inquiring into them. For while the trustee's investigatory powers in reorganization proceedings are undoubtedly broad, they may not transcend the limits specified by statute. Section 21 (a) of the Bankruptcy Act (11 U. S. C. 44 (a)) limits the scope of the examination to "the acts, conduct, or property of a bankrupt * * *," while Section 167 (11 U. S. C. 567), the other provision under which the expanded examination is here sought by the party being investigated, specifically requires the trustee's investigatory powers to be exercised with respect to "any * * * matter relevant to the proceeding or to the formulation of a plan * * *" Section 167 (1). The requested expanded investigation does not relate to the acts, conduct or property of the bankrupt; consequently, unless it is relevant to the proceeding or plan formulation, there is no statutory basis for it.

It is clear that the subject matter sought to be injected into the investigation is irrelevant to the statutory objective. In the absence of fraud, misconduct or breach of fiduciary obligation, secu-

rities of a debtor corporation purchased by public investors at a discount during the reorganization are not, for these reasons, subject to subordination, nor is the distribution to such purchasers affected by the circumstance that they had knowledge of grounds for subordination of another holder of the debtor's securities.

In *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, this Court held that Standard was to be subordinated on its claims against its subsidiary in reorganization, Deep Rock Oil Corporation. Public trading in Deep Rock's securities had continued when the question of subordination was first raised, while it was being litigated, and when the issue was adjudicated adversely to Standard. Public purchasers of Deep Rock securities during this period undoubtedly were on notice of the question of subordination and undoubtedly knew of this Court's decision (cf. R. 87). On Philadelphia Company's theory here, grounds existed for subordinating or limiting their claims. And on remand to the district court, Standard, advancing this theory, requested an inquiry into their acquisitions similar to that sought here. The district court refused, and was affirmed by the circuit court of appeals. *Standard Gas & Electric Co.* v. *Deep Rock Oil Corporation,* 117 F. 2d 615 (C. C. A. 10), certiorari denied, 313 U. S. 564.

The circuit court of appeals said (117 F. 2d at 619):

> In the order of July 24, 1940, the [district] court found that it would be impracticable to require the holders of securities to file statements showing the prices paid therefor, due to the number of securities outstanding and the extent of public dealing therein. There is no showing that this finding is not fully justified. Furthermore, the filing of such statements would not have benefited Standard. In the absence of fraud, the prices which security holders pay for their securities do not affect the measure of their participation under the plan of reorganization.[2]

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[2] Philadelphia Company's attempted distinction of the *Standard Gas* case (Pet. 31) is insubstantial. (a) No distinction can be inferred from the fact that in that case only the cost to public holders was sought to be ascertained while here time of acquisition and identity are added factors. Clearly an inquiry into cost would have required an identification of the security holders who purchased. As to time of acquisition, the decision in the *Standard Gas* case obviously related to discount purchases both before and during the proceedings and thus comprehended rather than excluded the scope of inquiry here sought by Philadelphia Company. (b) The circuit court of appeals in the *Standard Gas* case based its refusal to inquire into costs to public security holders squarely on the irrelevancy of the inquiry. The irrelevancy is not diminished, as Philadelphia Company suggests, because the inquiry is here requested before rather than after an adjudication that the parent be subordinated on its claims. (c) This court in deciding that Standard Gas should be subordinated to the public security holders of its subsidiary, had had before it no contentions with respect to the costs of acquisition by individual public security holders and accordingly the issue in respect of which Standard sought the inquiry on remand had not been foreclosed.

This holding is the uniform rule in reorganization. Unless special circumstances appear which are not here alleged—e. g., a fiduciary relationship by a security holder to a debtor,[3] dealings with a fiduciary, access to inside information, fraud, and the like—purchasers of securities at a discount during the reorganization are entitled to participate on a parity with other holders. *In re Lorraine Castle Apartments Building Corp.*, 149 F. 2d 55 (C. C. A. 7), certiorari denied, 326 U. S. 728; *Mokava Corporation* v. *Dolan*, 147 F. 2d 340 (C. C. A. 2); *Security-First Nat. Bank* v. *Rindge Land and Navigation Co.*, 85 F. 2d 557 (C. C. A. 9), certiorari denied, 299 U. S. 613; *In re Utilities Power and Light Corp.*, 29 F. Supp. 763, 770 (N. D. Ill.); *In re Indiana Central Telephone Co.*, 24 F. Supp. 342, 344 (D. Del.); *In the Matter of Point Building Land Company*, 37 A. B. R. (N. S.) 464, 466 (W. D. Pa); *In re Celotex Co.*, 12 F. Supp. 1, 5 (D. Del.).

As the *Lorraine Castle* case shows, a primary consideration in the consistent refusal of the courts, absent special circumstances, to subordi-

[3] This is the case with Philadelphia Company, but has not been alleged with respect to the public security holders. *American United Mut. Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138, and *In re McEwen's Laundry*, 90 F. 2d 872 (C. C. A. 6), cited by Philadelphia Company as justifying an inquiry into the cost of acquisition of the debtor's securities by security holders generally (Pet. 28–29), actually relate only to the cost to security holders occupying a fiduciary relationship to a debtor.

nate or limit purchasers at a discount during reorganization, is the preservation of the marketability of securities of debtor corporations. 149 F. 2d at 57–58. If the acquisition of such securities would subject the purchaser to the subordination or limitation of his claim, the price he paid would become the maximum he could obtain in distribution, and he might well receive less. In the face of such an unremunerative prospect, purchases of securities affected by a reorganization would be discouraged and the marketability of reorganization securities would be seriously curtailed if not completely destroyed. Those directly injured by such a rule would be the investors who acquired their holdings when the enterprise was solvent. With the disappearance of purchasers upon the commencement of the reorganization, or more probably on the first faint rumors of its possible approach, they would remain with no alternative but to hold on to an unmarketable security of declining value. As was pointed out in *Mokava Corporation* v. *Dolan, supra,* 147 F. 2d at 344–345:

> To reduce a creditor's participation in the plan to the amount he paid for his bonds (except in unusual circumstances not present here) would be harmfully to reduce the value of such bonds to those who previously owned them.[4]

[4] That indiscriminate injury would be a consequence of limiting purchasers during a reorganization to cost or of subordinating them appears to have been overlooked in

Nor is force added to Philadelphia Company's contentions by the assertion that the facts it seeks to have investigated are necessary to enable it "to prepare a defense to the charges [of mismanagement] made against it" (Pet. 9). The issues of mismanagement are now under investigation by the trustee pursuant to statute. A proper defense to such charges would be evidence of faithful management by Philadelphia Company. We do not observe any relevance in the circumstances of purchases by members of the public or their identity to the question of the fidelity of Philadelphia Company's management of the debtor. To the extent that "fair and equitable" treatment of publicly held securities may be affected by proof of its wrongdoing, Philadelphia Company is in no way prejudiced by profits resulting from purchases and sales within the class of public owners of those securities.[5] If, on the other hand, as Philadel-

Sprecher, *The Conflict of Equities Under the "Deep Rock" Doctrine* (1943) 43 Col. L. Rev. 336. It should be noted also that the conclusions of the article which are cited by Philadelphia Company (Pet. 21, 22) lack judicial support and are directly contradicted by the authorities that it discusses. See 43 Col. L. Rev. at 346, esp. notes 32 and 34.

[5] See *Phelan* v. *Middle States Oil Corp.*, 154 F. 2d 978, at 1001 (C. C. A. 2): "It is suggested that a purchaser (such as Cohen) should have no right against a receiver because otherwise the purchaser will acquire a windfall, since he, like the seller, knew nothing of that right when he purchased. But in a great variety of instances, purchasers are permitted to acquire windfalls, e. g., a buyer of land on which oil is discovered after the sale. The Restatement of Contracts, § 171 (2) reads: 'Unless otherwise provided in the assignment or

phia Company contends, members of the public who have acquired those securities in the course of the reorganization may have suspected such wrongdoings when they made their acquisitions, this factor presumably affected the prices they paid, and they should receive the benefits if the alleged wrongdoing of petitioner is substantiated.[8] Furthermore, if Philadelphia Company, through its contentions here, should be permitted to escape or reduce the subordination or limitation of its claims or to avoid causes of action against it even if its misconduct should be established, the result would be a totally undeserved windfall to a faithless fiduciary. This is a type of windfall that no court of equity should permit.

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by agreement of the assignee with the assignor or with the obligor, an assignee under an effective assignment for value has the same right to any securities for the assigned right that were available to the assignor, though he has not bargained for them, as if the assignor had agreed to transfer them.' If Glass [the receiver] was guilty of wrongdoing, that Cohen's estate will unexpectedly benefit can work no harm to Glass."

[8] *In re Lorraine Castle Apartments Building Corporation*, 149 F. 2d 55, 57–58 (C. C. A. 7): "To reduce the participation to the amount paid for securities, in the absence of exceptional circumstances which are not present here, would reduce the value of such bonds to those who have them and want to sell them. This would result in unearned, undeserved profit for the debtor, destroy or impair the sales value of securities by abolishing the profit motive, which inspires purchasers. This is even more evident when the purchaser acquires a lawsuit when he buys a debt. He hopes to realize more than he pays and at the same time runs the risks of recovering less."

Another consideration bearing upon the appropriateness of the added investigation sought by petitioner is the fact that in undertaking it the trustee would face overwhelming difficulties. As the Circuit Court of Appeals said (R. 89):

> The task of the trustee examining into all the bondholders of Pittsburgh Railways would be enormous. A large number of them have not filed individual claims. Under the District Court order of July 22, 1938 and Section 198 of Chapter 10 of the Bankruptcy Act this is not necessary unless they wish to vote on a reorganization plan. The debtor's bonds are widely held. They are on the open market and subject to changes of ownership. This might well result in some part at least of the proposed investigation being rendered useless. Viewed in the light of this complex, long drawn out reorganization, objection to such investigation as impractical would seem to have considerable merit despite appellant's offer to produce evidence to the contrary.

Indeed, if this effort by Philadelphia Company to have the trustee embark on an extensive inquiry into irrelevant facts had been successful, it would have served Philadelphia Company by diverting the trustee from his task of inquiring into acts of mismanagement by Philadelphia Company, and it would moreover have the mischievous effect of harassing the public security holders, and of adding still further to the numerous delays that have beset this proceeding.

None of the cases relied on by Philadelphia Company involve any conflict with the decision below. It is true that in a number of cases the courts have referred disparagingly to the motives of security holders who bought into a proceeding, especially where they bought in at low prices. But even in those cases, the courts have uniformly passed upon the merits of the security holders' contentions, and disposed of them on other grounds. *Godfrey* v. *Powell,* 150 F. 2d 486 (C. C. A. 5); *In re Missouri Pac. R. Co.,* 64 F. Supp. 64 (E. D. Mo.); *In re Midland United Co.,* 58 F. Supp. 667, 681 (D. Del.).

The two decisions of this Court cited by Philadelphia Company were in equity proceedings which in effect tried title to securities which, although acquired under dubious circumstances, would have yielded the complainants a huge speculative profit if equitable relief were granted. *Randolph* v. *Quidnick Co.,* 135 U. S. 457; *Mississippi & Missouri R. Co.* v. *Cromwell,* 91 U. S. 643. Refusal of relief in such cases is no authority for permitting the introduction of added subjects of investigation here, where, even if all of petitioner's factual allegations were true, no irregularity appears in the purchases by the public security holders, and where a reduction in distribution to public security holders by reason of the lateness

of their purchases would injure not only the recent purchasers but also long time investors. We are aware of no case, and petitioner has cited none, which permits such a result.[7]

It is thus clear that, even if the court should order the investigation prayed for by Philadelphia Company, learn the identity of each of the debtor's public security holders and the time and cost of his acquisition, and establish that some of them or many of them had, in fact, bought at a discount during the pendency of the proceeding and with knowledge or notice of grounds asserted for the limitation or subordination of Philadelphia Company's claims, all such information would be irrelevant to the issue as to whether to subordinate or limit the claims of such public holders, since they are not to be subordinated or limited for these reasons, nor is the extent of Philadelphia Company's subordination or limitation thereby to be reduced or avoided. Accordingly, the court below correctly affirmed the denial by the reorganization court of the application of petitioner.

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[7] The implication of petitioner that the expanded investigation is justified because the initial inquiry into Philadelphia Company was at the request of a security holder with an alleged questionable motive is immaterial even if true, for the inquiry into Philadelphia Company is for the benefit of all public security holders. *Young* v. *Higbee*, 324 U. S. 204, 214.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully submitted.

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